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MONTANA CORPORATION
INCOME TAX STUDY
BY DENNIS M. BURR , REVENUE ANALYST

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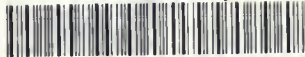
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MONTANA CORPORATION
INCOME TAX STUDY
BY DENNIS M. BURR , REVENUE ANALYST

A REPORT TO
GOVERNOR FORREST H. ANDERSON,
GOVERNOR-ELECT THOMAS L. JUDGE,
AND THE MEMBERS OF THE
FORTY-THIRD LEGISLATIVE ASSEMBLY

MONTANA DEPARTMENT OF REVENUE
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DECEMBER 1, 1972



STATE OF MONTANA

DEPARTMENT OF REVENUE

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December 1, 1972

TO: GOVERNOR FORREST H. ANDERSON
GOVERNOR-ELECT THOMAS L. JUDGE
MEMBERS OF THE FORTY-THIRD LEGISLATIVE ASSEMBLY

Gentlemen:

It gives me great pleasure to transmit to you this study of the Montana Corporation License Tax. In February of 1972, Governor Forrest H. Anderson ordered me as Director of Revenue to prepare this study to answer some of the questions surrounding the taxation of multistate corporations in Montana. The analysis was conducted by personnel of the Department of Revenue at no additional cost to the taxpayers of the state. Although this study is educational rather than analytical in many respects, I feel that it provides much of the information necessary for public officials to make rational decisions concerning the future of corporation taxes in Montana. The conduct and supervision of this study has been invaluable to me as Director of Revenue and I hope it proves of even more value to the Governor of Montana and the members of the Forty-Third Legislative Assembly.

Very truly yours,

A handwritten signature in cursive script that reads "Keith L. Colbo".

Keith L. Colbo
Director of Revenue



State of Montana
Office of The Governor
Helena 59601

FORREST H. ANDERSON
GOVERNOR

November 27, 1972

Mr. Keith L. Colbo, Director
Department of Revenue
Mitchell Building
Helena, Montana 59601

Dear Mr. Colbo:

On February 15, 1972, I ordered you as Director of Revenue to conduct a complete study of the Montana Corporation License Tax. As I indicated at that time, the public and the Legislature have long felt that there are corporations operating in Montana which do not pay their fair share of the cost of state and local government. A comprehensive study of corporate taxation in Montana is needed and statutory changes should be made to correct any inequities that exist in the present tax structure.

In order that the scope of your study is not limited unnecessarily by statutory restrictions, I am exercising my option as Governor under Section 84-1507, R.C.M. 1947, to authorize you to release information from the corporate files of the Department of Revenue. You may use whatever information you deem essential to provide me and the Forty-Third Legislative Assembly with a complete and factual analysis of the corporate tax structure of the State of Montana.

Sincerely,

A handwritten signature of Forrest H. Anderson in dark ink, written over a large, stylized flourish that extends to the left.

FORREST H. ANDERSON
Governor

TABLE OF CONTENTS

INTRODUCTION	1
CHAPTER I. INTERSTATE COMPARISON OF BUSINESS TAXES	12
CHAPTER II. FEDERAL AND STATE CORPORATION TAX LAWS	26
CHAPTER III. THE TAXATION OF INTERSTATE COMMERCE IN MONTANA . .	32
CHAPTER IV. AN ANALYSIS OF MONTANA CORPORATION TAX RETURNS . .	43
CHAPTER V. ADMINISTRATION OF MONTANA'S CORPORATION TAX LAWS . .	65
CHAPTER VI. CONCLUSIONS AND RECOMMENDATIONS	72

LIST OF TABLES

Table

1. Number of Corporations Paying License Tax by Industry and by Type of Corporation. Returns Filed Fiscal 1969	6
2. Montana Corporate License Tax Receipts by Industry and by Type of Corporation. Returns Filed Fiscal 1969	7
3. Percentage Contribution to Domestic and Apportioned Montana Gross Income by Industry and by Type of Corporation. Return Filed in Fiscal 1969	8
4. Percentage of State - Local General Revenue from Corporation Income Taxes, by State, 1962, 1967, 1970	15
5. State and Local Taxes with an Initial Impact on Business by Type of Tax, by State, 1967	18
6. Relationship of State and Local Taxes with an Initial Impact on Business to Total State and Local Taxes, by State, 1957, 1962, 1967	21
7. Selected Taxes Collected with an Initial Impact on Business, 9 Western States, 1967	23
8. Financial Data from Tax Returns of the Largest Multistate Corporations Filing Returns in Montana, 1969-70	47
9. Financial Data from Tax Returns of 48 Largest Domestic Corporations Filing Returns in Montana, 1969-70	48
10. Corporation License Tax Paid, as a Percent of Gross Receipts for Domestic and Apportioning Corporations, 1969-70	50
11. Non-Business Income Attributed to Montana and Total Non-Business Income Allocated to Montana	52
12. Potential Refunds due to Retroactive Loss carry back Provision of Corporation License Tax	56

INTRODUCTION

The corporation license tax is probably the least understood of Montana's major sources of revenue. Eleven million four hundred thousand dollars were collected by the Department of Revenue from this source in fiscal year 1971-72 and divided between the state general fund, the school foundation program, and the long-range building program. Yet, few citizens in Montana are cognizant of the tax rate, what businesses the tax applies to, or any of the other statutory provisions concerning the corporation license tax. Politicians from both parties have criticized the law and its administration, but seldom has the criticism been followed by recommendations that have improved the taxation of corporations by the state.

The Legislature has commissioned several studies of business taxation, the most recent published by the Legislative Council in 1968, and the Interim Committee on Fiscal Affairs in 1970. Both studies presented useful and informative data concerning the taxation of domestic and foreign corporations, but evidently neither were able to dispel the suspicion with which residents of the state regard the taxation of business. As a result, Governor Anderson requested a study of business taxation to be conducted by the Director of Revenue and asked that the study together with

any recommendations for statutory reform be presented to the 1973 session of the Montana Legislature.

Since two studies of the corporation license tax have been conducted within the past five years, there is no need to duplicate past efforts in this report. Many areas and aspects of business taxation are examined in this report that were not discussed in earlier studies. A brief review of the Legislative Council report on the Montana Corporation License Tax (report number twenty-six) and the section in the Montana Fiscal Affairs study dealing with the corporation license tax should be helpful.

MONTANA LEGISLATIVE COUNCIL REPORT NO. 26

The Montana Legislative Council undertook a study of the corporation license tax as a result of Senate Resolution number thirty-six, and House Resolution number twenty-four of the Fortieth Legislative Assembly. Both resolutions called for a study of the methods of taxing corporations that do business in Montana. While both resolutions give adequate justification for conduct of the study, those found in the House Resolution remain timely and are worth repeating. House Resolution number twenty-four noted that:

(1) There is a need to establish equity in taxation among all corporations doing business in the state of Montana.

(2) Many large and small Montana corporations pay a significant tax to the state of Montana at this time but some large corporations do not

appear to pay their fair share of corporate taxation based on the volume of their business and reported earnings.

(3) There is a need to assure that non-resident corporations doing business in Montana who either do not file corporation license taxes or do not appear to pay an amount based equitably upon their earnings on volume of business are properly taxed.

The resolution required the Legislative Council to present recommendations for improving both the collection and assessment of corporate license taxes in Montana to the 1969 Legislative Session. The same criticisms of the taxation of corporations are heard today as were evidenced by the House Resolution in 1967.

The Legislative Council report on the corporation license tax contains a short history of business taxes both nationally and in Montana, an explanation of the current tax practices in Montana, and a detailed empirical study of corporation license returns filed in Montana in 1966. Pursuant to its main purposes, this study concentrated heavily on the relationship between taxes paid by multistate corporations and those paid by domestic corporations to determine which firms had the heavier tax burden. Additionally, statistical analysis was directed at the effect of changing the apportionment formulas for multistate corporations and to the effect of replacing the current tax on net income with a tax on the gross income of corporations.

The results of the Legislative Council's analysis were surprising to many. With respect to the division of the tax burden between multistate and domestic corporations, the Council report concluded that ". . .multistate corporations share over twice the relative (tax) liability as that shared by domestic corporations." It was determined that a proposed change in the method of apportioning the income of foreign corporations would result in a loss of revenue to the state of 134,000 dollars and would shift more of the tax burden from multistate to domestic corporations. And, finally, the Council concluded that replacing the current net income tax with a tax on the gross income of corporations "would shift 10.92 percent of the present income tax liability from multistate to domestic firms . . ."

In summary, the Council did not recommend any major changes in the statutes relating to the corporation license tax because all of the changes that were investigated would have resulted in a shift in the tax burden away from multistate corporations to domestic corporations. The Council did recommend that money be appropriated to expand the corporation license tax staff. It also recommended that the state adopt a corporation net income tax to supplement the corporation license tax and it recommended that the state become a member of the Multistate Tax Compact. Both of the latter two recommendations were enacted by the Forty-First Legislative Assembly and will be discussed in a later chapter of this report.

The Legislative Council report published in 1968, refuted many of the misconceptions held by Montanans concerning the corporation license tax. Yet, the same criticisms of corporation taxes embodied in House Resolution number twenty-four are revived prior to every Legislative Session.

MONTANA FISCAL AFFAIRS STUDY

The Montana Fiscal Affairs Study conducted a very intensive and complete empirical analysis of the corporation license tax. A few comments should be sufficient to point out that the conclusions drawn from the analysis in the Montana Fiscal Affairs Study are basically the same as those reported in Legislative Council Report number twenty-six. Three of the tables prepared by the Fiscal Affairs Study staff are presented here as a basis for the discussion that follows.

TABLE 1

NUMBERS OF CORPORATIONS PAYING LICENSE TAX
BY INDUSTRY AND BY TYPE OF CORPORATION
RETURNS FILED FISCAL 1969

	<u>Domestic Corporations</u>	<u>Apportioning Corporations</u>	<u>Total</u>	<u>Percent of Total</u>
Agriculture	918	16	934	14.33
Forestry	9	1	10	.15
Metal Mining	35	6	41	.63
Coal	3	--	3	.05
Crude Oil & Nat. Gas	156	74	230	3.53
Other Mining	16	5	21	.32
Construction	364	103	467	7.17
Manufacturing	306	220	526	8.07
Transportation	104	44	148	2.27
Communication	61	6	67	1.03
Electric, Gas, & Water	16	4	20	.31
Wholesale Trade	288	75	363	5.57
Retail Trade	1,279	117	1,396	21.43
Finance, Insurance, & Real Estate	665	59	724	11.11
Banks	--	--	--	--
Bldg. & Loans	8	--	8	.12
Credit Unions	22	--	22	.34
Services	609	118	727	11.16
Unallocable	54	2	56	.86
Rentals	574	25	599	9.20
Cooperatives	147	5	152	2.33
Total	5,634	880	6,514	

Source: Derived from data in The Montana Fiscal Affairs Study, Page 473.

TABLE 2

MONTANA CORPORATE LICENSE TAX RECEIPTS
BY INDUSTRY AND BY TYPE OF CORPORATION
RETURNS FILED FISCAL 1969

	<u>Domestic Corporations</u>	<u>Apportioning Corporations</u>	<u>Total</u>	<u>Percent of Total</u>
Agriculture	\$ 354,844	\$ 2,856	357,700	4.6
Forestry	30,800	10	30,810	.4
Metal Mining	507	388,708	389,215	5.0
Coal	8,877	--	8,877	.1
Crude Oil & Nat. Gas	37,593	342,849	380,442	4.9
Other Mining	7,396	2,887	10,283	.1
Construction	301,826	46,128	347,954	4.5
Manufacturing	831,977	677,009	1,508,986	19.4
Transportation	60,478	299,299	359,777	4.6
Communication	69,218	769,183	838,401	10.8
Electric, Gas & Water	27,538	1,409,061	1,436,599	18.5
Wholesale Trade	179,029	60,448	239,477	3.1
Retail Trade	665,487	378,429	1,043,916	13.4
Finance, Insurance, & Real Estate	321,387	29,641	351,028	4.5
Banks	--	--	--	--
Bldg. & Loans	33,487	--	33,487	.4
Credit Unions	3,608	--	3,608	--
Services	174,447	59,406	233,853	3.0
Miscellaneous	15,274	111	15,385	.2
Rentals	158,951	2,071	161,022	2.1
Cooperatives	24,752	8,369	33,121	.4
Total	\$3,307,476	\$4,476,465	\$7,783,941	
Percent of Total	42.5	57.4		

Source: Derived from data in The Montana Fiscal Affairs Study, page 474.

TABLE 3

PERCENTAGE CONTRIBUTION TO DOMESTIC
AND APPORTIONED MONTANA GROSS INCOME
BY INDUSTRY AND BY TYPE OF CORPORATION
RETURNS FILED IN FISCAL 1969

	<u>Domestic Corporations</u>	<u>Apportioning Corporations</u>	<u>Percent of Total</u> ¹	<u>Rank</u>
Agriculture	2.31	.02	2.36	10
Forestry	.17	--	.18	15
Metal Mining	.01	3.79	3.80	7
Coal	.02	--	.02	20
Crude Oil & Nat. Gas	22.30	3.66	26.00	1
Other Mining	.14	.03	.18	15
Construction	4.72	.73	5.46	5
Manufacturing	6.56	14.40	20.97	2
Transportation	.92	3.82	4.77	6
Communication	.18	1.09	1.28	13
Electric, Gas, & Water	.12	1.50	1.63	11
Wholesale Trade	6.64	.81	7.47	4
Retail Trade	12.99	3.95	16.96	3
Finance, Insurance, & Real Estate	1.25	.12	1.38	12
Banks	--	--	--	--
Bldg. & Loans	.11	--	.12	17
Credit Unions	.02	--	.03	19
Services	2.99	.48	3.56	8
Unallocable	.07	--	.09	18
Rentals	.37	--	.40	14
Cooperatives	1.53	1.75	3.30	9
Total	63.68	36.29	100.00	

¹ Detail may not add to totals due to rounding.

Source: Derived from data in The Montana Fiscal Affairs Study, page 478.

Table one presents data on the number of foreign and domestic corporations filing returns in Montana. The data prepared by the Fiscal Affairs Study staff is more disaggregated than that prepared by the Legislative Council. It is also more detailed than the data presented later in this report. For purposes of comparison, our interest is confined to domestic corporations and foreign apportioning corporations. Foreign corporations using separate accounting are accounting for income and operating exactly as domestic corporations. Thus, in this study as in the Legislative Council Report, separate accounting firms are treated as domestic corporations. Combining the totals from Table One shows that 86.49 percent of the firms filing returns in Montana in 1969, were either domestic or separate accounting firms. Thirteen and fifty-one hundredths percent of the firms were apportioning foreign corporations. Table Two shows the percentage of total license tax revenue received from each type of firm. Combining the totals as was done with data in Table One shows that 42.5 percent of the 1969 corporation license tax was collected from domestic and separate accounting firms and the remaining 57.5 percent was collected from apportioning multistate firms. Thus, foreign corporations represented only 13.51 percent of all firms filing returns, but they paid 57.5 percent of the corporation license tax in 1969. This discrepancy can partly be explained by the fact that apportioning multistate firms are generally larger and have more

income than Montana corporations. However, Table Three indicates that the size of foreign corporations does not completely explain the discrepancy between the tax burden on foreign and domestic corporations. Table Three shows the percentage contribution to Montana gross income from each type of filing. Domestic corporations accounted for 63.68 percent of total gross income and apportioning multistate firms accounted for 36.32 percent of total gross income. Therefore, the apportioning companies comprise 13.51 percent of all corporations filing returns, account for 36.32 percent of gross income, and pay 57.5 percent of the corporation license tax collected by the State of Montana. The conclusion drawn from this data is about the same as that reported by the Legislative Council. That is, multistate apportioning firms bear a heavier tax burden in relation to their income than do domestic corporations.

The Fiscal Affairs Study data also confirms the Legislative Council's contention that a gross income tax would shift part of the total tax burden from apportioning multistate firms to Montana based corporations. In short, multistate firms appear to be paying more than their fair share of the corporation license tax and there does not seem to be any acceptable modifications to the existing statutes that will allow Montana to export more of the corporation tax than it does under the present statutes.

Despite the statistical evidence presented in the two most recent corporation tax studies, the feeling still persists among legislators and citizens alike that some corporations, especially foreign corporations, are not paying their fair share of taxes to the State of Montana. Further analysis of the same type in this study would do little to change this attitude. This study takes a different approach to the problem of taxing corporations. Our objective is to illuminate the inequities in the tax structure, explain why they occur, and offer solutions where possible. We hope that a better understanding of the problems involved with state taxation of corporations will result from this study.

CHAPTER ONE

INTERSTATE COMPARISONS OF BUSINESS TAXES

People are interested in interstate tax comparisons as a measure of the normalcy of their own state's tax system. Also, State Governments are hesitant to let their tax systems get out of line with those of other states because of the effect state taxes have on industrial locations. In all likelihood, too much emphasis has been placed on the role that taxes play in industrial location. Businesses are more concerned with the availability of a good labor supply, access to markets and raw materials, transportation costs, and the quality of life in an area than they are in the state tax structure. In addition, the stability of a state's tax structure is probably more important to businesses than current tax rates. A state with relatively high tax rates and a record of tax stability is generally preferable to a state that currently has low tax rates and a history of frequent, major changes in its tax system. Still, interstate tax comparisons are a valuable guide to policy makers if they are properly presented and used in conjunction with other important data to formulate changes in the state tax system. However, they should not be used in an attempt to normalize the state tax structure by forcing all state taxes to conform to someone's concept of the "national average." Economic data

can be, and has been, used to show that taxes in Montana are high, average, and low when compared to taxes in other states. This type of data is among the easiest to manipulate to prove a preconceived notion about the state tax system.

All too often, interstate tax comparisons are confined to the comparison of revenue from one tax source. This type of analysis is misleading because of the diversity in tax systems among the states. For example, statistics that show that Montana's income tax is higher than average should be tempered with the knowledge that Montana has no general sales tax. When sales and income taxes are combined, Montana is shown to have lower than average taxes. Similarly, the corporation license taxes paid by a "typical" firm in Montana and other states are not a valid comparison because of the relative importance of other business taxes in each state. Finally, the difference between services provided by state and local governments in the various states will affect many comparisons. For example, Hawaii has the lowest local property taxes in the Nation. This is not necessarily the result of more efficient and lower cost local government, but because education is financed by state, not local, taxes in Hawaii. Similarly, statistics that show Montana state taxes as being low do not account for the fact that local governments in Montana levy taxes to pay for services that are paid for by the State Government in many other states. The fact

that state taxes are low is often merely an indication that local taxes are high. All of these factors must be considered when making interstate tax comparisons if they are to be used as a factor in formulating policy.

The most reliable source of information for interstate comparisons is "The Census of Governments" conducted every five years by the Department of Commerce. The latest year for which data is available is 1967. Some information is available for more recent years and is used occasionally in this study. It should be noted, however, that statistics for non-census years are partially estimated and based on a sample of government units, not a complete enumeration. Our analysis indicates that Montana's relative tax position has not changed drastically in the last few years so conclusions drawn from 1967 statistics should be representative of current conditions.

Table Four shows the percentage of total state and local general revenue derived from corporation income taxes for 1962, 1967, and 1970. Montana received two percent of total state-local general revenue from this source in 1970 and ranked twenty-fourth among the fifty states. Montana was considerably below the national average of 2.9 percent of total general revenue derived from taxes on corporation income in 1970. Table Four is of interest for two reasons. First, it shows that Montana's rank among the

TABLE 4

PERCENTAGE OF STATE-LOCAL GENERAL REVENUE
FROM CORPORATION INCOME TAXES,
BY STATE, 1962, 1967, 1970

<u>STATE</u>	<u>1962</u>	<u>1967</u>	<u>1970</u>
UNITED STATES, Total	2.3	2.5	2.9
Alabama	1.3	2.4	1.8
Alaska	1.3	1.2	0.4
Arizona	1.1	1.7	1.8
Arkansas	2.5	3.6	3.0
California	4.1	3.9	3.5
Colorado	2.9	2.4	2.3
Connecticut	4.3	6.0	6.1
Delaware	4.7	4.5	3.5
Dist. of Columbia	3.5	3.2	4.5
Florida	-	-	-
Georgia	2.5	3.8	3.5
Hawaii	2.7	2.2	2.1
Idaho	2.4	2.9	2.8
Illinois	-	-	1.9
Indiana	-	0.7	0.3
Iowa	0.5	0.9	1.4
Kansas	1.2	2.2	1.4
Kentucky	2.9	3.3	2.4
Louisiana	2.2	2.1	1.6
Maine	-	-	1.5
Maryland	2.0	2.2	2.3
Massachusetts	1.8	2.1	5.7
Michigan	-	-	3.3
Minnesota	2.9	3.6	3.1
Mississippi	2.6	2.0	1.7
Missouri	1.0	0.8	0.9
Montana	1.8	2.1	2.0
Nebraska	-	-	0.9
Nevada	-	-	-
New Hampshire	-	-	-

TABLE 4
Page 2

<u>STATE</u>	<u>1962</u>	<u>1967</u>	<u>1970</u>
New Jersey	1.3	1.6	3.9
New Mexico	1.1	1.1	1.1
New York	4.3	3.9	4.3
North Carolina	5.3	5.7	4.7
North Dakota	0.8	0.9	0.7
Ohio	-	-	-
Oklahoma	1.9	1.9	1.9
Oregon	3.2	3.1	2.9
Pennsylvania	4.8	5.4	8.0
Rhode Island	3.9	4.5	4.0
South Carolina	3.5	5.3	3.8
South Dakota	0.2	0.2	0.2
Tennessee	2.6	3.1	3.2
Texas	-	-	-
Utah	2.3	2.1	1.7
Vermont	1.7	2.3	1.8
Virginia	3.2	3.0	2.8
Washington	-	-	-
West Virginia	-	-	0.4
Wisconsin	4.1	4.9	3.4
Wyoming	-	-	-
Montana Rank	26/50	25/50	24/50

Note: Minor amounts of local corporation income taxes (other than D.C) included with individual income taxes. Separation not available.

1 Includes portion of the corporation excise taxes and surtaxes measured by corporate excess. Separation not available.

Source: ACIR staff computations based on various reports of U.S. Bureau of the Census, Governments Division.

fifty states has not changed significantly during the period from 1962 to 1970. Thus, 1967 statistics should be representative of current conditions. Second, it should be noted that table four relates to only one source of business taxation. As explained above, the relative position of a state's tax system cannot be based on an analysis of only one tax source. Montana ranks in the middle of the states in income taxes collected from corporations and is considerably below the national average. However, Table Five shows all of the taxes businesses paid to state and local governments during 1967. Table Five was prepared by the Advisory Council on Intergovernmental Relations and it overcomes most of the common objections to interstate comparisons. It shows data for all major tax sources so the comparisons are not distorted by the relative importance of a single tax source in the different states. Also, the data is based on total state and local taxes so the relative importance of each level of government does not distort the comparisons. Corporation income taxes amounted to slightly less than ten percent of the total state and local taxes paid by businesses in Montana in 1967. Property taxes, mainly for the support of local government, totaled 54.5 million dollars compared to corporation income taxes of 7.6 million dollars. The fact that government in Montana relies heavily on property taxes, and property tax payments are deductible on the corporation license tax return, helps explain why Montana can have a higher than average

TABLE 5

STATE AND LOCAL TAXES WITH AN INITIAL IMPACT ON BUSINESS,
BY TYPE OF TAX, BY STATE, 1967
(In millions of dollars)

States	Total	Property	Corporation Net Income	Gross Receipts	Licenses	Other
United States	17,853.4	10,217.8	2,478.6	2,110.6	2,085.0	961.3
Alabama	154.6	50.6	29.9	20.5	49.6	40.0
Alaska	23.5	7.9	3.5	2.1	5.9	4.1
Arizona	139.4	103.7	14.4	12.2	9.1	--
Arkansas	82.1	34.5	25.1	8.8	9.2	4.5
California	2,391.0	1,626.1	452.6	146.3	148.8	17.2
Colorado	190.8	130.2	25.8	13.5	20.2	1.1
Connecticut	308.2	163.7	80.1	47.9	12.9	3.6
Delaware	51.2	8.9	12.7	3.2	24.6	1.8
Dist. of Columbia	78.7	41.3	14.9	12.7	8.3	1.5
Florida	416.0	220.7	--	80.2	87.1	28.0
Georgia	256.3	140.6	64.6	20.3	30.8	--
Hawaii	48.0	18.0	10.5	14.3	5.1	.1
Idaho	62.2	41.6	9.6	4.4	6.4	.2
Illinois	804.2	555.2	--	177.9	71.1	--
Indiana	399.2	297.7	14.5	72.2	14.5	.3
Iowa	170.0	134.1	12.0	12.4	11.5	--
Kansas	185.7	134.9	23.9	13.3	12.8	.8
Kentucky	136.4	58.5	46.3	12.3	18.2	1.1
Louisiana	488.8	150.4	34.4	29.7	59.0	215.3
Maine	63.4	52.1	--	7.3	4.0	--
Maryland	291.9	180.4	40.8	40.8	29.8	.1
Massachusetts	530.5	302.1	56.0	28.3	142.3	1.8
Michigan	838.1	522.7	9.1	35.0	142.1	129.2
Minnesota	409.3	250.6	69.6	49.0	17.8	22.3
Mississippi	128.3	69.2	17.0	10.7	20.2	11.2
Missouri	285.9	183.0	21.0	41.5	40.4	--
Montana	76.4	54.5	7.6	5.2	5.6	3.5
Nebraska	77.1	59.2	--	7.2	10.0	.7
Nevada	57.3	33.2	--	2.9	21.2	--
New Hampshire	45.1	37.6	--	3.9	3.5	.1

TABLE 5
Page 2

States	Total	Property	Corporation Net Income	Gross Receipts	Licenses	Other
New Jersey	643.8	362.6	48.5	142.7	90.0	--
New Mexico	86.7	31.9	6.5	6.9	10.1	31.3
New York	2,617.2	1,408.3	637.1	241.6	168.7	161.5
North Carolina	316.5	113.8	98.5	63.4	40.8	--
North Dakota	40.7	25.2	3.3	2.9	5.8	3.5
Ohio	872.1	625.7	17.8	106.6	122.0	--
Oklahoma	200.3	98.3	21.5	21.8	13.2	45.5
Oregon	201.8	123.0	32.2	14.6	31.2	.8
Pennsylvania	915.6	303.3	244.5	73.8	269.7	24.3
Rhode Island	75.5	40.2	17.5	10.9	6.0	.9
South Carolina	147.3	65.8	43.4	17.8	18.1	2.2
South Dakota	38.6	27.2	.6	3.1	7.5	.2
Tennessee	210.4	95.1	43.3	23.3	46.2	2.5
Texas	982.5	573.1	--	96.8	87.8	224.8
Utah	86.9	63.3	11.0	4.8	4.5	3.3
Vermont	32.2	21.1	4.9	3.5	2.7	--
Virginia	285.0	107.6	49.3	73.4	48.8	5.9
Washington	313.9	127.3	--	154.0	31.5	1.1
West Virginia	145.1	50.6	--	79.1	14.6	.8
Wisconsin	407.6	251.5	102.8	31.8	21.4	.1
Wyoming	44.2	39.7	--	1.8	2.6	.1

1/ Excluding unemployment compensation. 2/ Insurance premium, utility, and general gross receipts taxes on business firms. 3/ Corporation franchise and miscellaneous business and occupational licenses.

Source: Estimates prepared by ACIR staff from data published by the Governments Division, U. S. Bureau of the Census, and U. S. Department of Agriculture.

corporation tax rate and collect less than the average amount of revenue from this source.

Table Six shows the percentage relationship between state and local taxes with an initial impact on business and total state and local taxes for 1957, 1962, and 1967. In 1967, 35.9 percent of all taxes collected by state and local governments in Montana were collected from business firms. This was 6.6 percentage points above the national average. Montana ranked fifth in the Nation in the percent of total state-local taxes collected from business.

Although the preceding tables presented show that Montana is collecting more taxes from business than does the average state, it is also interesting to compare Montana to surrounding states with similar economic and demographic characteristics. To the extent that taxes are a factor in industrial location, a comparison of Montana's tax system to neighboring states is relevant.

Table Seven shows the percentage each type of business tax bears to total business taxes in Montana and eight neighboring states. Although Montana collects an exceptionally large percentage of business tax revenue through the property tax, this is partly a result of circumstances peculiar to sparsely populated western states. All states in Table Seven, with the

TABLE 6

TABLE 6.--RELATIONSHIP OF STATE AND LOCAL TAXES
WITH AN INITIAL IMPACT ON BUSINESS TO TOTAL
STATE AND LOCAL TAXES, BY STATE, 1957, 1962, 1967/
(Dollar amounts in millions)

<u>STATES</u>	Taxes on business as <u>% of total taxes</u>			
	<u>1957</u>	<u>1962</u>	<u>1967</u>	<u>1957-1967</u>
United States	34.2	32.1	29.3	-13.6
Alabama	26.0	24.4	22.8	-12.3
Alaska	n.a.	30.7	27.4	n.a.
Arizona	32.7	30.0	26.6	-18.7
Arkansas	26.6	23.0	20.9	-21.4
California	32.8	31.8	30.7	- 6.4
Colorado	31.4	31.1	28.2	-10.2
Connecticut	32.6	34.3	31.4	- 3.7
Delaware	27.8	30.5	28.8	+ 3.6
Dist. of Col.	31.0	30.1	28.6	- 7.7
Florida	32.4	31.1	25.6	-21.0
Georgia	25.4	26.7	25.0	- 1.6
Hawaii	n.a.	17.3	16.0	n.a.
Idaho	34.5	33.7	30.3	-12.2
Illinois	30.0	27.8	24.7	-17.7
Indiana	37.2	38.2	27.1	-27.2
Iowa	19.9	21.9	18.5	- 7.0
Kansas	29.7	28.8	25.9	-12.8
Kentucky	28.9	23.8	20.2	-30.1
Louisiana	48.0	53.3	51.0	+ 6.3
Maine	28.9	26.2	25.0	-13.5
Maryland	28.7	26.5	24.9	-13.2
Massachusetts	33.6	31.0	26.5	-21.1
Michigan	35.3	34.6	30.9	-12.5
Minnesota	39.7	35.9	32.6	-17.9
Mississippi	32.5	33.0	27.8	-14.5
Missouri	28.7	26.8	23.8	-17.1
Montana	38.8	37.4	35.9	- 7.5
Nebraska	23.2	21.5	19.8	-14.7
Nevada	36.9	33.6	34.5	- 6.5
New Hampshire	31.8	28.0	25.5	-19.8

TABLE 6
Page 2

<u>STATES</u>	<u>Taxes on business as</u> <u>% of total taxes</u>			
	<u>1957</u>	<u>1962</u>	<u>1967</u>	<u>1957-1967</u>
New Jersey	40.8	37.2	28.7	-29.7
New Mexico	28.0	36.5	31.9	+13.9
New York	35.2	32.2	31.1	-11.6
North Carolina	32.5	29.4	28.0	-13.8
North Dakota	23.2	23.5	22.8	- 1.7
Ohio	31.4	34.7	33.4	+ 6.4
Oklahoma	34.0	31.0	31.8	- 6.5
Oregon	35.4	34.5	32.0	- 9.6
Pennsylvania	38.2	29.5	28.2	-26.2
Rhode Island	33.2	28.5	28.3	-14.8
South Carolina	28.4	27.0	28.8	+ 1.4
South Dakota	18.5	19.3	18.9	+ 2.2
Tennessee	26.5	27.2	25.6	- 3.4
Texas	52.1	45.2	39.8	-23.6
Utah	38.2	33.7	29.0	-24.1
Vermont	26.8	26.2	24.0	-10.4
Virginia	37.2	34.2	26.6	-28.5
Washington	30.6	29.6	28.3	- 7.5
West Virginia	41.5	36.1	36.2	-12.8
Wisconsin	35.5	29.9	26.9	-24.2
Wyoming	40.3	35.4	40.1	- 0.5
Montana Rank	6/48	4/50	5/50	

n.a. Data not available.

1/ Excluding unemployment compensation.

Source: Estimates prepared by ACIR staff from data published by the Governments Division, U.S. Bureau of the Census, and U.S. Department of Agriculture.

TABLE 7

SELECTED TAXES ON BUSINESS AS A PERCENTAGE OF TOTAL TAXES COLLECTED
WITH AN INITIAL IMPACT ON BUSINESS, 9 WESTERN STATES, 1967

	<u>Property</u>	<u>Corporation Net Income</u>	<u>Gross Receipts</u>	<u>License</u>	<u>Other</u>	<u>Total</u>
Colorado	68.2	13.5	7.1	10.6	.6	100.0
Idaho	66.9	15.4	7.1	10.3	.3	100.0
Montana	71.3	9.9	6.8	7.3	4.6	100.0
North Dakota	61.9	8.1	7.1	14.3	8.6	100.0
Oregon	61.0	16.0	7.2	15.5	.4	100.0
South Dakota	70.5	1.6	8.0	19.4	.5	100.0
Utah	72.8	12.7	5.5	5.2	3.8	100.0
Washington	40.6	--	49.1	10.0	.3	100.0
Wyoming	89.8	--	4.1	5.9	.2	100.0
U. S. Average	57.4	13.8	11.8	11.6	5.3	100.0

Source: Derived from Estimates of State and Local Taxes Initially Paid By
Business Firms: 1957-1962-1967: ACIR, March 4, 1970

exception of Washington, are well above the national average in the percentage of total business taxes collected through property taxation. Six of the nine western states rely less heavily than average on corporation net income taxes and all states except Washington get a smaller than average percentage of revenue from gross receipts taxes. Thus, Montana's business tax structure is quite different from the national average, but it is similar in most respects to other states in the same geographic region.

While these interstate comparisons cannot provide evidence that Montana's, or any other state's, corporation income tax is too high or too low, several meaningful conclusions can be drawn from the data. First, Montana relies on business taxes for a larger share of state and local taxes than does the average state. More significantly, Montana relies on business taxes for a greater share of total tax revenue than all but one of the states in the same geographic region. This may have an adverse affect on industrial location in Montana. Second, the property tax is used more intensively in Montana as a source of business tax revenue than it is in most other states. This is primarily a result of constitutional restrictions on state-local revenue sharing which has necessitated almost total reliance on property taxes to finance local schools and local government. Third, while the statistics show that the corporation license tax contributes a smaller percentage of total state tax revenue in Montana than it

does in other states, this does not indicate that corporations are failing to pay their fair share of state and local taxes. The evidence indicates that the mix of business taxes in Montana is considerably different than that in other states. The heavy reliance on local property taxes paid by businesses in Montana is partial explanation and justification for lower than average receipts from the corporation license tax. Overall, the total tax burden on businesses operating in Montana seems to be higher than the tax burden in most other states.

This analysis shows that, on the average, Montana is doing quite well in requiring businesses to pay their share of the costs of state and local government. However, the questions regarding business taxation that are continually asked do not relate to averages, but are directed at the taxable status of particular firms operating in the state. It does not answer the questions if we note that business taxes, on the average, are high in Montana without addressing the problem of large corporations that pay no tax or a negligible amount of tax to the state. Consequently, the remainder of this study focuses on the Montana Tax Law, its inequities, and the particular companies that seemingly earn income in Montana and escape most state and local taxes.

CHAPTER TWO

FEDERAL AND STATE CORPORATION TAX LAWS

The taxation of domestic corporations (corporations doing business in only one state) does not present any particular problems in Montana. All such corporations are registered with the Secretary of State and the Department of Revenue. Consequently, they are easy to find, their financial records are readily available, and most of them understand and comply with state tax laws. The problems faced by Montana and all other states concerns the taxation of interstate corporations. This area is regulated by Federal laws and court interpretations of the Interstate Commerce Clause of the Federal Constitution. It has become increasingly difficult, over the years, for any state to achieve what it considers to be fair taxation of interstate firms without discriminating unfairly against domestic firms. Before discussing Montana's methods of taxing corporations, it is necessary to briefly review some of the Federal legislation and court decisions that affect the states' powers to tax interstate corporations.

The Interstate Commerce Clause is regarded by many as one of the most important sections of the United States Constitution in promoting the early industrial growth of the country. This section gave Congress the power to "regulate commerce with foreign nations and among the several states, and

and with the Indian tribes." Congress was able to provide protection for new industries by insuring that interstate commerce was not taxed by the states and by a tariff system that protected American firms from foreign competition. The protection and stimulation of interstate businesses by Congress and the courts was instrumental in establishing an economic system that bound the states together into a strong Nation. During this early period in American history, states were not allowed to levy any taxes that might be construed to inhibit the profits of interstate corporations. However, by the beginning of the twentieth century, interstate businesses did not need total protection from state taxes. On the contrary, the states were demanding tax money from firms engaged in interstate commerce which used state services. During this period, only indirect taxes could be levied on interstate commerce. This allowed a state to tax interstate commerce only if the firm had some intrastate business in the state. Firms engaged completely in interstate commerce could not be taxed. During the 1930s and 1940s, the courts started to change the philosophy of the Interstate Commerce Clause. The opinion emerged that the commerce clause was not designed to help multistate companies escape their share of state taxes. In 1959, this new philosophy was fully implemented by the United States Supreme Court in two cases involving the Northwestern Portland Cement Co. and the Stockham Valves and Fittings Company. The majority opinion of the court

held that "net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus (contact) to support the same." This was the first time that a state tax was upheld where interstate commerce exclusively was involved. This decision upset the business community because of the multitude of state taxes to which interstate commerce would be subjected. Companies claimed, with some justification, that the cost of complying with the tax laws of fifty states would be prohibitive and the effect could be to tax interstate corporations on more than one hundred percent of their income. Consequently, Congress passed, and the President signed, Public Law 86-272 on September 19, 1959. This law, in effect, reversed the Supreme Court's decision regarding the taxation of interstate commerce by the states.

First, Public Law 86-272, prohibits states from taxing corporations whose only activity in the state is soliciting orders through the use of salesmen. Second, a corporation cannot be taxed if sales are made by an independent agent. That is, salesmen who are not strictly employees of the parent corporation. This law allows many corporations to sell their products in a state without being subject to state corporation income taxes. Thus, state tax laws invariably work a hardship on domestic firms producing and selling the same products as corporations engaged in interstate commerce.

The domestic company has the added burden of state taxes which must be reflected in the price of its products or in its profits. Foreign corporations that do not pay the state tax will either sell products at lower prices or realize a greater profit on activity in the state than the domestic corporations.

There are, basically, two methods that a state may use to tax the income of corporations. A state may impose a direct net income tax or a tax on the privilege of doing business in the state based on net income. While the effect of the two is basically the same, they each have certain legal advantages. Montana has used a privilege tax since 1917. The corporation license tax is a tax on the privilege of doing business in the state and the tax is assessed against the net income of corporations. The main advantage of the privilege tax is that it reaches some income that is not taxable under a direct income tax. For example, the interest earned from government bonds is not taxable under a direct income tax, but it can be taxed through the privilege tax. Thus, the privilege tax is advantageous for taxing financial organizations and other corporations that earn income from government bonds. This is a large source of income to many corporations operating in Montana.

The major disadvantage of the privilege tax is that it cannot be levied against the income of corporations engaged strictly in interstate

commerce. This was inconsequential until the Northwestern Portland Cement case because, until that time, no state taxes could be levied on interstate commerce. In 1971, Montana adopted a Corporation Net Income Tax to be applied to those companies not taxable under the Corporation License Tax. This so called "double barreled" corporation net income tax was enacted to allow Montana to tax those corporations that are taxable under Public Law 86-272, but are not taxable under the privilege tax. Obviously, the exclusions in 86-272, mentioned above, limit the number of firms that are liable for the net income tax. Still, experience during the first year of its operation indicated an increase in taxes collected by the state of more than one hundred thousand dollars.

Montana's corporation tax laws are superior to those in most states. The double barreled tax allows the maximum number of foreign corporations to be subject to state taxes and the provisions for apportioning the income of foreign corporations are the same as those recommended by the Multi-state Tax Compact. In addition, Montana does not allow a deduction for Federal taxes paid, as is the practice in many states. This means that the state tax structure is proportional, rather than regressive as is the case when Federal taxes are deductible on the state return.

Montana has gone about as far as it can in passing legislation designed to tax foreign corporations. Still, because of the provisions in Federal

laws and the courts interpretations of the Commerce Clause, many companies seem to escape Montana taxes.

CHAPTER THREE

THE TAXATION OF INTERSTATE COMMERCE IN MONTANA

The discussion in this chapter is quite different than any found in previous studies of corporation taxes in Montana. The basic reason is that while other studies have explained the laws that relate to the taxation of interstate commerce, they have not relieved the public or the Legislature of the feeling that poor state laws and bad administration are the reasons that many foreign corporations pay no income tax to the State of Montana. At the outset, it should be emphasized that the corporations discussed in this chapter are complying with all State and Federal Laws. Consequently, any criticism of the taxable status of various corporations or industry groups that result from this analysis should be directed principally at Public Law 86-272, not at the industries or corporations involved.

Restrictions in the United States Constitution on the state's power to tax interstate corporations are found in Article 1, Section 8, the Commerce Clause; Article 4, Section 2, which prohibits a state from discriminating against citizens of another state; and the Fourteenth Amendment which protects the civil rights of individuals and corporations against the assertion of rights on the part of the states. Naturally, a state has the power to tax a corporation "doing business" within its jurisdiction, but a firm

definition of "doing business" has never been formulated. Public Law 86-272, answered some of the questions by limiting the states' power to tax, but questions not specifically covered by 86-272 still must be decided individually by the Federal Courts system. Thus, many of the guidelines which determine whether or not a state can tax a multistate corporation are found in court transcripts, not in Federal or State statutes.

Two of the specific exclusions in 86-272 contribute to a tax system where all firms earning income in the state are not taxed. The first of these prohibits the taxation of corporations that merely solicit business from within a state. The corporations may have any number of full-time salesmen working and living in the state, but if the orders they solicit are not final until approved by out-of-state offices of the corporation, the company cannot be taxed. Most companies that specialize in door-to-door sales campaigns are very careful not to violate the provisions of Public Law 86-272 that limit their tax liability to their home state. The State of Montana has never received a corporation license tax return from the Encyclopedia Britannica Corporation; the American Corporation, publishers of the Encyclopedia Americana; the Fuller Brush Company; or Avon Beauty Salons Inc. In fact, we are unable to find one major United States corporation which specializes in door-to-door sales campaigns that has ever filed a tax return in Montana. All such companies

are careful to have all sales that are written in Montana approved by an out-of-state office and they maintain no inventories, warehouses, or sales offices in the state that might make them liable for Montana's corporation income taxes. As such, they are protected by the solicitation exemption of Public Law 86-272.

Companies that depend on mail order solicitations are also immune from state corporation taxes. Thus, mail order houses, seed and plant dealers, and others who depend on solicitation through the mails are not liable for state taxes. The Time-Life Corporation, Newsweek Inc., Readers Digest, and other major magazine corporations pay no income tax to the various states in which they solicit orders even though the majority of their products are sold in states other than the one in which their main offices are located. All of these firms are considered to be engaged exclusively in interstate commerce and not subject to state regulation or taxation.

While the tax treatment of corporations that only solicit sales in the state may seem to be inequitable, the important point is that there is nothing the state can do to correct the situation. The exemption afforded to these companies is a part of Federal, not State law.

The second major exemption in Public Law 86-272 involves independent collection agents. This exemption allows a corporation to have any number of dealers selling its products in a state as long as the dealers are not

technically employed by the parent company. These independent dealers may maintain offices, advertise the product they sell, and keep an inventory of merchandise. Under normal circumstances, these actions would make the parent corporation subject to state taxes. However, as long as the dealers are independent of the parent corporation, the state may not tax the parent corporation. Naturally, the independent dealers must pay all pertinent state taxes. A few examples may clarify this provision of Public Law 86-272.

Coca Cola and Pepsi Cola are both bottled and distributed in Montana by local bottling companies franchised by the parent companies. Pepsi Cola operates strictly through independent distributors, bottling companies that are not technically owned or controlled by the parent company. Consequently, the Pepsi Cola Company does not file a return or pay any corporation taxes to the State of Montana. The Coca Cola Company, on the other hand, has operations that exceed those allowable under Public Law 86-272. Although the operations of the two firms are parallel in most respects, the Coca Cola Company has a negligible amount of payroll and owns a small amount of property in Montana. This is sufficient to establish nexus in Montana for tax purposes. Thus, Coca Cola of Atlanta, Georgia, pays corporation taxes to Montana based on the total apportioned income of the parent corporation. Although the firms are seemingly identical, one is taxable in Montana and the other one is not.

The independent distributors exemption is utilized by many other corporations that sell products and earn income from operation in Montana. Anhauser Bush, producer of Budweiser Beer; the Olympia Brewery; Sicks Brewery, producer of Rainer Beer; and the Shasta Beverage Company are all examples of firms selling in Montana through independent distributors. None of these corporations file returns or pay corporation taxes in Montana.

None of the major tobacco companies (R.J. Reynolds, American Tobacco Company, Liggett & Meyers) file returns in Montana. All cigarettes sold in Montana are imported, stored, and dispensed by independent distributors. None of the manufacturing companies have, as yet, established sufficient contact with the state to make them liable for state corporation taxes. Here again, the independent distributors are liable for all applicable state taxes.

Perhaps the strangest twist in Public Law 86-272, as it applies to Montana, concerns the manufacture and sale of liquor. As far as we can ascertain, the only liquor producer that pays corporation taxes to Montana is Alpha Industries of Helena, Montana, producer of Lewis & Clark Gin and other products. All other liquors sold in Montana are imported, warehoused, and sold by an independent distributor. The parent corporations are engaged strictly in interstate commerce and may not be taxed by the state.

The interesting point with respect to liquor is that the independent distributor for these companies is the State Liquor Control Board. Thus, the state cannot tax the profits of the manufacturer or the independent distributor. In addition, there are no property taxes collected on liquor warehousing facilities, and there is no chance that the manufacturers will ever establish sufficient nexus to be liable for state corporation taxes. In fact, foreign corporations are prohibited by state law from establishing sufficient contact with the state for corporate tax purposes.

The use of independent distributors to sell the products of foreign corporations is not unique to the tobacco and beverage industries. Most of the products appearing on supermarket shelves in Montana are produced by corporations that pay no income tax to the state regardless of the volume of their sales in Montana. In fact, if a corporation produced a product in Idaho and made one hundred percent of its sales in Montana through supermarkets and other independent distributors, the provisions of Public Law 86-272 would preclude any taxes from being levied against the manufacturer by the State of Montana.

The solicitation and independent distributor exemptions are the main features of Public Law 86-272 that protect interstate commerce from state taxes. However, Public Law 86-272 is not the only Federal limitation on the

states' power to tax multistate corporations. Supreme Court interpretations of the United States Constitution are also limiting, if not as explicitly as Federal Law.

One example of the courts influence on state corporation taxes involves occasional sales. The courts have held that a corporation making an occasional sale in a state or conducting business that can be construed to be an isolated act, is not subject to state taxes. Although no general rule is given as to how much business and how many acts constitute "an occasional sale", the intentions of the corporation with respect to future operations in the state are usually considered by the court. In *Pennsylvania vs. McKee*, the court said: "to be doing business in this state implies corporate continuity of conduct in that respect; such as might be evidenced by the investment of capital here, with the maintenance of an office for the transaction of business, and those incidental circumstances which attest the corporate intent to avail itself of the privilege to carry on business. In short, it would have to appear that the corporation and its officers intended to establish a continuous business and not one of temporary character"¹. Thus, a large corporation may sell its products in Montana on an occasional basis, but if it does not clearly show intentions of carrying on a permanent business in the state, it is not liable for taxes on the income it earns in the state.

1 (1905) 183 N.Y. 98, 75NE935

We have no examples of such an occurrence in Montana, but it would appear that a firm could engage in sufficient activity in Montana to be taxable in spite of Public Law 86-272, but escape tax under the occasional sale ruling. For example, a foreign corporation could sell a multi-million dollar piece of industrial equipment to a Montana corporation and not pay tax to the state on the profits from the sale. This would be the case if the foreign corporation did not show an intent to engage in future business activities in the state.

Despite the exemptions noted above and others, there are more than 1,200 foreign corporations paying corporation taxes to the State of Montana. These firms have sufficient connections with the state to make them liable for state taxes. Generally, a firm is taxable in Montana if it (1) has a sales office in the state, (2) pays employees working in Montana that are not merely solicitors or salesmen, (3) owns property in Montana, or (4) maintains a stock of goods or repair parts in the state. Considering the provisions of Public Law 86-272, it is surprising that so many corporations operate in a manner that makes them taxable in Montana. Of course, taxes paid to Montana are generally deductible from taxable income in other states and on the Federal corporation income tax return.

In many cases, the Federal Law results in the state being able to tax one foreign corporation, but not another on the basis of relatively minor

differences in the business operations of the two firms. For example, automobile manufacturers are, generally, not taxable in Montana. The manufacturers produce and stockpile automobiles for sale to independent distributors throughout the Nation. The vehicles are shipped to dealers in interstate commerce and most manufacturers do not have sufficient operations in Montana to establish a taxable status. Of the leading manufacturers, only General Motors is taxable in Montana. This is because General Motors maintains two warehouses in Montana. Since cars are brought into Montana by the parent company and then sold to distributors, General Motors is engaged in intrastate business in Montana. As a result, Montana is entitled to tax an apportioned share of the entire income of the General Motors Corporation. While our share is not large, it is sufficient to make General Motors one of the larger corporate taxpayers in the state.

At the same time, Ford, Chrysler, and American Motors pay no corporate taxes to Montana. Their vehicles are sold directly to independent dealers from out-of-state and they are stored in warehouses which are not owned by the parent companies. None of these corporations have ever filed a corporation license tax return in Montana. The Department of Revenue is currently investigating whether or not these corporations are liable for taxes under the new corporation income tax law, but in all likelihood,

their activities are sufficiently limited to preclude state taxation under Public Law 86-272.

This chapter has not covered all of the provisions in Federal Law and court decisions that affect the states' power to tax interstate commerce. However, the discussion should be sufficient to illustrate what a complicated and, at times, inequitable system of corporate taxation has emerged over the years. The confusing and conflicting rules governing interstate commerce make it necessary for all states to employ highly qualified auditors, lawyers, and economists in an effort to deal fairly with both domestic and foreign corporations. The lack of clarity in the Federal Laws also contributes to the public distrust of both corporations and tax officials who are conscientiously attempting to comply with Federal and State laws.

The solution to the problems faced by the states in attempting to raise revenue from interstate corporations and to the problems of the corporations dealing with tax laws of a large number of states would seem to be in good Federal legislation. The states and the corporations need a uniform set of regulations to follow that clearly define taxable status and insure that the aggregate burden placed on interstate businesses by the states is not excessive. At present, it is simply impossible to determine whether or not a corporation is liable for state taxes without a complete

and expensive investigation of its business conduct. This is unfair to both the corporations and the states. It is also nearly impossible for the public to evaluate the efficiency of tax agencies or the performance of corporations in paying their share of the cost of state and local governments.

CHAPTER FOUR

AN ANALYSIS OF MONTANA CORPORATION TAX RETURNS

The most valuable section of any tax study in generating new information is an analysis of recently filed tax returns. The Legislative Council report and the Montana Fiscal Affairs Study conducted extensive analysis of Corporation License Tax returns and some of the results of those studies are summarized in the introduction of this report. The Fiscal Affairs Study is reasonably current and contains data from an expensive and exhaustive enumeration of all returns. We have not attempted to duplicate this information, but have, instead, concentrated on several questions that can be answered with a more selective analysis of corporation tax returns.

One of the major problems faced by researchers interested in corporate taxation in Montana is the lack of reliable data. Every time a new study is undertaken, a procedure for gathering data must be designed. In the past the desired information has been requested from the Board of Equalization and gathered by Department employees. This is an extremely time consuming process and, unfortunately, each study is slightly different from preceding studies, so the information supplied is not always comparable from one study to the next. Consequently, one purpose of this analysis was to investigate the feasibility of providing statistical data from corporation tax

returns on an annual basis. The returns are quite complicated and often contain many schedules (returns containing fifty pages or more are not a rarity). However, the information is of sufficient importance to justify data processing of corporation license tax returns. An attempt will be made to computerize corporate tax data during the next fiscal year. If this program is successful, the data needed by researchers and legislators to properly evaluate corporate taxation will be available annually.

The chapter dealing with state taxation of interstate commerce explained some of the ways that corporations escape state corporation taxes even though they earn income from their operations in Montana. This chapter discusses who pays the tax and some of the methods that corporations may use to reduce their tax burden. The first section contains an analysis of the 100 largest corporate taxpayers in Montana.

There are approximately 8,700 corporations in the files of the Department of Revenue that have paid, or are currently paying, the Corporation License Tax. Seven hundred of these firms are inactive and pay no tax; 1,500 are inactive in Montana, but continue to file an information return and pay the fifty dollar minimum tax; 2,100 are small business corporations that pay a ten dollar filing fee; 1,400 are active corporations which pay the fifty dollar minimum tax; and 3,000 corporations pay more than fifty dollars

per year in corporation license taxes. In fiscal year 1970, the average tax paid by the 3,000 corporations paying more than the fifty dollars minimum was 3,100 dollars.

Nine million five hundred and ninety-five thousand nine hundred and four dollars were collected from the corporation license tax in fiscal year 1970. Of this amount, 5,968,357 dollars, or 62.2 percent of the total was collected from the 100 largest firms. Three million six hundred and sixty-four thousand five hundred and fifty-five dollars, or more than thirty-eight percent, of the total tax was collected from eight firms that pay taxes in excess of 100,000 dollars each. These statistics point out that the burden of the tax is not uniformly distributed among the corporations doing business in Montana. The 2,900 firms paying more than the minimum tax, but less than the 100 largest firms, had an average tax liability of 1,250 dollars in fiscal year 1970. The 100 largest taxpayers had an average corporation tax burden of 59,684 dollars.

The number of domestic and multistate firms comprising this group is remarkably close. Fifty-two firms were multistate corporations that apportioned income to Montana and forty-eight corporations were domestic and conducted all of their business in the state. The forty-eight domestic corporations paid a total of 1,209,679 dollars in corporation license taxes while the multistate firms paid 4,758,678, or almost four times as much. The fifty-two apportioning firms in this group paid almost fifty percent of the total corporation license tax collected in fiscal year 1970.

Tables Eight and Nine show financial data for the 100 largest foreign and domestic corporations paying taxes in Montana. The multistate power companies pay the most tax of any foreign or domestic corporations. The three apportioning firms in this group paid almost two million dollars in corporate license taxes in 1970. The greatest number of firms are in the wholesale-retail category. This category includes firms which would be considered manufacturers nationally, but whose main business in Montana consists of selling products either through wholesale or retail outlets. The twenty apportioning firms in this category paid 656,997 dollars in corporate taxes in fiscal year 1970.

Interest is usually expressed in an alternative to Montana's system of taxing the income of corporations and a gross receipts tax is almost always suggested as the principal alternative. Table Ten presents data from the forty-eight domestic and fifty-two foreign corporations relating to a gross receipts tax. A gross receipts tax is one method Montana could use to tax the non-business income of foreign corporations. This income (dividends and interest) generally is not taxable except in the home state of corporations. Several states use this provision to encourage industrial location in their state. By passing laws that exempt interest and dividends from state taxes, a company that locates in the state escapes all state taxes on this income since it cannot be taxed by other states and is not taxed by the home state.

TABLE 8

FINANCIAL DATA FROM TAX RETURNS
OF 52 LARGEST MULTISTATE CORPORATIONS
FILING RETURNS IN MONTANA, 1969-70

	Number of Firms	Total Gross Receipts	Montana Gross Receipts	Total Net Income	Montana Taxable Income	Tax Liability
Finance, Insurance	--	--	--	--	--	--
Power	3	285,439,389	104,742,084	53,187,251	31,335,834	1,958,489
Agriculture	--	--	--	--	--	--
Forestry	--	--	--	--	--	--
Construction	1	144,961,370	15,911,403	19,679,547	1,184,579	74,036
Manufacturing	4	1,417,632,499	58,660,399	90,837,840	3,143,721	196,482
Wholesale-Retail	20	53,434,294,526	297,328,627	6,850,608,579	10,481,887	656,997
Services	1	1,096,236	460,790	446,832	178,400	11,150
Communications	2	690,304,884	62,657,937	182,136,632	16,136,010	1,008,501
Mining	3	1,026,036,059	10,839,813	180,750,066	1,139,322	71,208
Oil and Gas	13	15,921,216,888	110,803,497	1,290,072,652	9,823,976	613,999
Transportation	5	1,819,647,093	96,380,581	120,108,136	5,379,073	167,816
Total	52	74,740,628,944	898,610,394	8,787,827,535	78,802,802	4,758,678

TABLE 9

FINANCIAL DATA FROM TAX RETURNS OF 48 LARGEST
DOMESTIC CORPORATIONS FILING RETURNS IN MONTANA, 1969-70

	<u>Number of Firms</u>	<u>Total Gross Receipts</u>	<u>Taxable Income (Net Income)</u>	<u>Tax Liability</u>
Finance & Insurance	4	4,821,745	912,086	57,006
Power	1	4,502,183	484,402	30,275
Agriculture	3	1,219,789	685,883	42,868
Forestry	6	37,607,070	3,649,269	228,078
Construction	5	10,995,568	1,023,095	64,470
Manufacturing	8	99,626,186	5,323,525	332,722
Wholesale-Retail	10	69,890,594	3,536,955	221,047
Services	5	6,150,819	1,628,637	101,790
Communication	1	3,973,690	419,363	26,210
Mining	1	2,852,483	346,006	21,625
Oil and Gas	4	10,129,478	1,337,386	83,588
Total	48	251,769,605	19,346,607	1,209,679

Table Ten indicates that on the average, a gross receipts tax would shift the burden from foreign corporations to domestic corporations. That is, the present method used to apportion corporate income to Montana results in a larger tax base from multistate corporations than could be obtained from a gross receipts tax even though the gross receipts tax would apportion some of the corporations non-business income to the state. Rather than changing Montana's tax system so that non-business income is taxed, it would be better to insist on federal legislation that would disallow any income earned by a corporation to be classified as non-business income.

Table Ten points out that the current tax represents .53 percent of apportioning corporations gross receipts and .48 percent of the gross receipts of domestic corporations. Table Ten illustrates another disadvantage of gross receipts taxes. In order to maintain the current burden distribution, the state would have to adopt a variable rate schedule and tax industries at different rates. According to the table, the rates would have to vary from 3.51 percent of the gross receipts of domestic agricultural corporations to .15 percent of the gross receipts of foreign oil corporations. (The tax on oil firms is a smaller percentage of gross receipts than that of other industries principally because of the depletion allowance available to the oil industry). A business tax system with different tax rates applied to different industries is unwise because it can be subject to strong political

TABLE 10

CORPORATION LICENSE TAX PAID AS A PERCENT OF
GROSS RECEIPTS FOR DOMESTIC AND APPORTIONING CORPORATIONS, 1969-70

	<u>Gross Receipts</u> <u>Apportioning</u> <u>Corporations</u>	<u>Gross Receipts</u> <u>Domestic</u> <u>Corporations</u>	<u>Tax as % of</u> <u>Gross Receipts</u> <u>Apportioning</u> <u>Corporations</u>	<u>Tax as % of</u> <u>Gross Receipts</u> <u>Domestic</u> <u>Corporations</u>
Finance & Insurance	--	4,821,745	--	1.18
Power	104,742,084	4,502,183	1.87	.67
Agriculture	--	1,219,789	--	3.51
Forestry	--	37,607,070	--	.61
Construction	15,911,403	10,995,568	.47	.59
Manufacturing	58,660,399	99,626,186	.33	.33
Wholesale-Retail	297,328,627	69,890,594	.22	.32
Services	460,790	6,150,819	2.42	1.65
Communications	62,657,937	3,973,690	1.61	.66
Mining	10,839,813	2,852,483	.66	.76
Oil & Gas	110,803,497	10,129,478	.15	.83
Transportation	96,380,581	--	.17	--
Total	898,610,394	251,769,605	.53	.48

influences. Those industries with the most political influence are likely to end up with the lowest tax rates.

During the past year Montana and other states belonging to the Multi-state Tax Compact have been pressuring corporations to apportion more of their non-business income among the states in which they are taxable. It is intolerable for a corporation to claim that millions of dollars of dividends and interest income were not a direct result of the firm's total operations. In fiscal year 1970, one firm among the 100 largest reported non-business income in excess of 344 million dollars. This income, from dividends and interest, could not be taxed by any state other than the corporation's home state. This firm is headquartered in California, one of the states that exempts dividends or interest from taxation as an incentive to encourage corporations to locate in the state. Consequently, this 344 million dollars was not subject to any state taxes. If the non-business income of this firm had been apportioned and taxable in Montana, it would have increased the corporation's tax bill by 100,013 dollars. Table Eleven shows the effect of non-business income of the fifty-two largest multistate firms on the Montana Corporation License Tax. Column one is non-business income attributed to Montana and taxable as net income under the present tax laws. Column two shows the amount of money that would be taxable in Montana if all non-business income were apportioned to the states as is other income. Column four shows the net

TABLE 11

NON-BUSINESS INCOME ATTRIBUTED TO MONTANA
AND TOTAL NON-BUSINESS INCOME ALLOCATED TO MONTANA

	Non-Business Income Attributed To Montana	Total Non-Business Income Allocated To Montana	Column 2 Minus Column 1	Increase In State Tax If Non-Business Income Were Apportioned Rather Than Allocated In Montana
Finance, Insurance	--	--	--	--
Power	561,746	1,259,509	+ 697,763	43,610
Agriculture	--	--	--	--
Forestry	--	--	--	--
Construction	--	110,086	+ 110,086	6,880
Manufacturing	12,824	843,609	+ 830,785	51,924
Wholesale-Retail	5,338,693	6,164,743	+ 826,050	51,628
Services	4,294	1,587	- 2,707	- 169
Communication	21,463	139,610	118,147	7,384
Mining	31,367	2,211,879	2,180,512	136,282
Oil and Gas	346,498	3,696,305	3,349,807	209,363
Transportation	1,311,436	3,173,935	1,862,499	116,406
Total	7,628,321	17,601,263	9,972,942	623,308

increase in tax to Montana if non-business income were apportioned rather than allocated to the state in which it is earned. Montana would have realized an additional 623,308 dollars in taxes if non-business income had been apportioned to the states in the 1970 Fiscal Year. Unfortunately, federal action is required if this income is to become taxable to the states. The largest increase would have been in taxes paid by the oil and gas producers who would have paid an additional 209,363 dollars in corporation license taxes. At present, apportioning oil companies seem to pay the least taxes of any industry in relation to their gross receipts which could be allocated to Montana.

Foreign corporations, on the average, pay higher taxes in relation to their gross receipts than do domestic corporations. In some cases, it would seem that tax equity would demand even more taxes from apportioning firms than they are now paying. However, it is beyond the states' legal authority to tax some income of these firms so the inequities will continue to exist until federal legislation is enacted which eliminates the concept of "non-business" income.

One additional problem relating to the taxation of corporations that should be mentioned is the loss carry back deduction passed by the 1971 Legislative Assembly. On the surface, the concept of a loss carry back

seems to be reasonable and fair to the corporations and to the state. The reasoning is as follows:

	NET INCOME <u>Year 1</u>	NET INCOME <u>Year 2</u>	NET INCOME <u>Year 3</u>
Company A	50,000	50,000	50,000
Company B	(50,000)	50,000	100,000

Without the loss carry back provision, each firm will pay the same amount of tax to the state (based on \$150,000 of positive income over the three year period) even though firm B's net income over the period is only 100,000 dollars and firm A's total net income was 150,000 dollars. A two year loss carry back provision allows firm B to deduct the loss incurred in year one from income earned in year two in computing the corporation tax. The effect is to allow firm B to pay no tax in year one and year two and pay tax on 100,000 dollars of income in year three. Thus, both firms pay tax on the net income they earned over the three year period.

Those who support the concept of the loss carry back argue that it produces a fairer distribution of the tax burden among corporations. Opponents of the loss carry back point out that it allows firm B to operate in Montana and enjoy the benefits of government services for two years without contributing anything in taxes towards the cost of government

services. In any event, the loss carry back will have a profound effect on state revenues and the distribution of taxes between domestic and multistate corporations, especially if the courts rule that the carry back applies retroactively. The initial impact of the loss carry back will be a loss in revenue from the corporation license tax of two million dollars or more. Most of this will be in the form of refunds of taxes already paid. After the initial adjustments the state will continue to collect approximately one million dollars less per year than it would have if the loss carry back provision had not been implemented. Since most of the state's major corporate taxpayers are multistate firms, the primary effect of the loss carry back will be to reduce the tax on foreign corporations.

Table Twelve shows the refunds that could be claimed by eight multistate firms with operations in Montana under retroactive loss carry back. The situation with these firms is similar to that of corporation B in the example discussed earlier. If firm B had paid tax on the 50,000 dollars earned in year two and then a loss carry back law was passed retroactively, firm B could file an amended return deducting the loss in year one from income earned in year two. The state would then be required to refund the tax paid on income earned in year two. The eight companies listed in Table Twelve are all multistate corporations and the

TABLE 12

POTENTIAL REFUNDS DUE TO RETROACTIVE LOSS CARRY BACK
PROVISION OF CORPORATION LICENSE TAX

<u>Corporation</u>	<u>Refund</u>
1	\$ 69,404
2	386,626
3	59,899
4	61,521
5	218,367
6	173,258
7	20,056
8	<u>56,334</u>
Total	<u>\$1,045,465</u>

total refunds that will be available to these corporations is in excess of one million dollars.

Despite the problems involved with the corporation license tax, it is as good a system for collecting revenue from major corporations as the state could devise. In general, it is superior to a gross receipts tax and, coupled with the new corporation income tax, Montana is taxing the maximum number of corporations operating in the state. Most of the problem areas that exist in Montana are beyond state control and will only be corrected by federal legislation dealing with the taxation of interstate commerce.

The remainder of this chapter is devoted to a discussion of small business corporations operating in Montana. This is one area that has not received individual attention in other tax studies even though small business corporations represent a sizeable portion of Montana's business activity.

There are three requirements that a business must meet if it is to qualify for the small business option under Montana's corporation license tax laws. First, the company must have fewer than eleven stockholders; second, all stockholders must be residents of Montana; and third, the corporation must issue only one class of stock. Any business meeting these criteria may file tax returns as an electing small business corporation. There are several advantages to incorporation for small or family owned

businesses. A small business corporation enjoys all the legal benefits of a regular corporation, including access to the courts, limited personal liability for the shareholders, and the ability to raise larger amounts of capital by selling shares in the business. The emphasis in this report is on the effect the small business option has on state corporation tax revenue.

Corporations that elect to be taxed under the small business option file a corporation tax return which gives all the financial information required of a normal corporation. There is a ten dollar filing fee payable at the time the return is filed. The income that would normally be taxed under the corporation license tax is then distributed to the stockholders of the small business corporation on the basis of stock ownership. Each stockholder must report this income on the individual income tax return and pay personal income taxes on the corporate profits the same as he would on other types of income. Thus, the net income of small business corporations is taxed under the individual income tax law, not the corporation license tax law. Consequently, the total corporate tax collected in Montana is understated by the amount of the tax from small business that is credited as individual income tax collections.

There are 2,100 small business corporations listed in the files of the Department. 1,473 of these firms were active and filed returns in fiscal year 1970.

The remainder are either new filings since 1970, or inactive corporations that no longer file returns. Financial information was taken from the returns of all corporations that filed returns in 1970 for an analysis of the impact of the small business option on state tax revenue.

The 1,473 small business corporations that filed returns in 1970 reported total net (taxable) income of \$17,946,353. Since the average effective rate of taxation on Montana adjusted gross income was 2.18 percent in calendar year 1969, approximately 391,230 dollars of corporate small business taxes was collected and reported as individual income tax. In addition, 14,730 dollars were collected from small business corporation filing fees. The total tax collected from these businesses was 405,960 dollars.

It is interesting to compare the tax actually paid on the income earned by small business corporations with the amount they would pay if they were taxed as normal corporations. First, all small businesses pay a minimum tax of ten dollars rather than fifty dollars paid by normal corporations. There were 508 firms with income of less than 800 dollars in fiscal year 1970. These firms paid a total of 5,080 dollars in corporate taxes under the small business option, but would have paid 25,400 dollars if they were subject to the normal fifty dollar minimum tax that applies to other corporations. The remaining 1,235 small businesses had positive income of 17,946,353 dollars

which was taxed as personal income. The shareholders in these firms paid approximately 400,800 dollars in individual income taxes and in corporation filing fees. If these firms had been subject to the corporation license tax rate of 6.25 percent, they would have paid taxes amounting to 1,121,647 dollars. Thus, the initial loss in tax revenue attributable to the small business option was 741,087 dollars in fiscal year 1970; but, this is only part of the cost of the small business option.

Small business corporations that sustain a loss on operations also distribute this loss among the shareholders of the firm and the corporate loss may be deducted from any other income the shareholder may have. The 508 firms with net income of less than 800 dollars showed a total loss on operation of 5,548,494 dollars. If these losses were used to offset other income earned by the shareholders of the corporations, it cost the state approximately 231,650 in personal income taxes. Coupled with the losses discussed previously, the total cost in tax revenue of the small business option amounted to more than 972,000 dollars. This is almost ten percent of the total corporation tax collected in 1969-70.

While it may be justifiable for the state to offer tax incentives to small businesses, it should be remembered that the size of the corporation has nothing to do with qualifying for the small business option and its tax advantages.

In fact, many small business corporations have greater total sales and income than many regular corporations that pay taxes under the higher corporation license tax structure. Tax neutrality demands that economic decisions be based on business conditions and circumstances, not on differences in the tax treatment of alternative business structures. The decision to form a corporation, a partnership, a small business corporation, or a sole proprietorship should be based on the type of organization that offers the best business advantages to the firm, not on the tax advantages available under one of the options. Montana's small business option is undoubtedly patterned after the federal tax provisions, but it should be noted that not all states with corporate taxes based on federal law allow the small business option. North Carolina, for instance, specifically excludes this provision in their state corporation tax system.

There are several other advantages to persons who operate small business corporations. One of these is income splitting. This is probably most noticable in family farms and other family corporations. By making all family members shareholders in a family corporation, the profits on the business can escape the higher tax rates of the individual income tax. For example, a sole proprietor of a family business with taxable income of 10,000 dollars would pay personal income taxes on this amount. If the business were incorporated with five family members as stockholders, each member would pay

tax on only 2,000 dollars of income and, thus, remain in the lowest taxable bracket. Four hundred and fifty, or 30.5 percent of 1,473 small business corporations filing returns in 1970 were farms and ranches although less than seventeen percent of state employment and less than ten percent of total personal income in Montana is earned on farms.

The deductibility of compensation paid to officers of small business corporations is also of interest. Compensation of officers is a legitimate business expense as is depreciation, salaries of employees, and the purchase of raw materials. The small business option, however, allows corporate losses to be deducted from individual income tax returns of corporate shareholders. Since shareholders are typically the officers of small business corporations, the deduction for compensation to officers seems to be allowed twice. For example, a small business corporation with one major shareholder owning ninety-nine percent of the stock, could end the taxable year in the following position. Business income after all deductions except for the compensation of officers is zero. The president and principle stockholder of the corporation is paid a salary of 10,000 dollars. The result is 10,000 dollars of personal income to the president and a 10,000 dollar loss on operations to the corporation. The loss on operations is distributed to the shareholders on the basis of stock ownership. The corporation president and major stockholder is credited with a 9,900 dollar loss on the business operations.

This loss is deductible on his individual income tax return. Thus, the president has received 10,000 dollars of income from the corporation and may deduct 9,900 dollars of corporate losses leaving him with 100 dollars of taxable income prior to all the other deductions allowed under the Individual Income Tax statutes.

Not all of the small business corporations which operated at a loss in 1970 were able to pay compensation to officers. However, 231, or forty-five percent, of the 508 firms showing a corporate loss realized this loss partly because of the deduction of compensation to officers. These 231 corporations recorded officers compensation of 2,610,723 dollars and corporate losses of 3,233,570 dollars, more than enough to insure that individual income taxes were not paid on the 2.6 million dollars of officers salaries. Seventy-six, or thirty-three percent, of these firms were small business corporation farms and ranches.

The small business option may be a desirable feature of the corporation license tax law. It does impart a degree of progressivity into an otherwise proportional tax structure. Since small business corporations generally have smaller gross receipts and earnings than normal corporations and pay taxes at lower rates, the tax is rendered progressive. However, if progressivity were the goal of corporate taxation, it would be easier to make the system

progressive by establishing a progressive rate structure and subjecting all corporations to the same statutory rules and regulations. In any event, some of the features of the small business option appear to allow these corporations to reduce their tax well below what might be expected from a cursory review of the tax laws. This claim is often leveled at large corporations, but is seldom associated with domestic, small business corporations.

CHAPTER FIVE

ADMINISTRATION OF MONTANA'S CORPORATION TAX LAWS

The first question that comes to mind with respect to the administration of corporation taxes is how many corporations simply do not pay the tax that they owe to the state. This question places the tax administering agency in a delicate position. Obviously, if the administering agency were aware of tax evasion, it would be able to identify the guilty companies and assess the tax. Thus, the incidence of tax evasion is a question that cannot be answered at the state level because if it exists, it is unknown. Congress commissioned a study of the taxation of interstate commerce, which sheds some light on the problem of tax evasion. This study, published in 1964, dealt with all aspects of state taxation of interstate commerce including tax evasion. The study included a detailed examination of the business operations and taxable status of some 1,200 corporations engaged in business in more than one state. The general conclusion of the investigation is that companies pay their taxes in the states in which they have their principal offices. The more tenuous the company's contact with a state, the more likely that business taxes are not paid. More specifically, the study reported that:

(1) Of 819 companies soliciting sales and accepting orders in various states, returns were being filed in less than three percent of the cases.

(2) Of 130 instances of corporations maintaining sales offices in various states, returns were being filed in only about forty percent of the cases.

(3) Of 234 cases where companies had goods warehoused in various states, returns were being filed in only about forty percent of the cases.

These figures indicate that of 1,183 firms which were legally taxable in various states during the survey, only 164 returns were filed. Thus, of the firms sampled, less than fourteen percent of the returns that should have been filed in the various states were actually filed.

Since Montana is smaller in population than most other states, it is unlikely that compliance problems are as serious here as they are in more urban areas. Business activity is noticable in Montana and it is easier to identify and tax than activities in states with a high concentration of corporate activity. Still, it must be true that some firms owe taxes in Montana that are never paid. It is also true that some firms which do file returns do not pay as much tax as they should. Both of these problems could be alleviated somewhat by assigning additional staff to the corporation license tax bureau but, as the congressional study concludes, all states are dependent on the Federal Government for help in eliminating the problems involved in taxing multistate corporations. Currently, the corporation license tax bureau is staffed by six persons. The staff consists of a

bureau chief, one desk auditor, two field auditors and two clerk-typists. Both field auditors have been hired within the past year and two additional field auditors will be employed if the positions are funded by the 1973 Legislature. Still, without federal legislation to precisely define taxable status and some type of interstate cooperative agreements, corporations will escape taxes in states where they have only slight business contacts.

The Department of Revenue uses several sources to aid in identifying taxable corporations. The Secretary of State compiles a list of all new corporations registered with the state on a monthly basis. This is by far the main source of information on new firms doing business in Montana. It should be noted, however, that all firms registered with the Secretary of States office are not necessarily taxable in Montana. The department also receives copies of all corporation audits performed by the Internal Revenue Service on corporations operating in Montana. These reports are valuable in that a reassessment at the federal level will probably result in additional state taxes since Montana's tax laws closely resemble federal tax laws. The department is also aided by other state and federal agencies such as the Montana Highway Department which provides a list of all new highway contracts awarded. Several sources of information from other divisions of the Department of Revenue are also available. A list of all firms reporting

withholding taxes is compiled monthly by the Income Tax Division; public contractor licenses and recently issued store licenses are provided by the Miscellaneous Tax Division; and some information is available from the Property Tax Division. Exchange of information agreements are in effect with several neighboring states so that tax returns from corporations operating in more than one state can be compared for accuracy and completeness. The Department of Revenue is using all available sources of information to locate and establish the taxable status of corporations which conduct business in the state.

In addition to the sources of information available from within the state and from the Federal Government, Montana is a member of the Multistate Tax Compact. This is potentially a very useful organization for all states in arriving at fair taxation of interstate corporations. The Multistate Tax Compact was enacted by the Montana Legislature in 1969. There are nineteen member states in the Compact and the states share in the administrative costs of the Compact staff. Montana has contributed approximately 2,000 dollars per year for the three years of active membership. The purposes of the Compact are to:

- (1) Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

(2) Promote uniformity or compatibility in significant components of tax systems .

(3) Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration .

(4) Avoid duplicative taxation .

The main advantage to Montana and most other states is in the audit function performed by the Multistate Tax Compact staff. The staff solicits the approval of all member states in conducting audits of companies engaged in business in more than one state. The audit results are then available to the member states involved. This saves the states the administrative costs of nineteen audits by the individual states and results in a more complete audit since the multistate staff has information supplied to it by all of the member states. It also saves the corporations the expense of submitting to audit by all of the individual states. In fiscal year 1972, Montana realized almost 40,000 dollars from multistate audits of businesses operating in Montana. This is a good return on the 2,000 dollars invested by the state Department of Revenue in the form of annual dues to the Compact. The future value of the multistate organization is in jeopardy at the present time. Some corporations refuse to allow representatives of the Multistate Compact to audit their books for the member states. These firms maintain that they are only required to allow actual representatives of the various states to examine their books and

that the Multistate Tax Compact has no legal status to audit interstate corporations unless it is recognized by Congress. A suit has been filed against the Compact and its members in a federal court to enjoin the Compact from conducting audits of multistate corporations. This class action suit has been filed jointly by the United States Steel Corporation; Standard Brands, Incorporated; General Mills, Incorporated; and the Procter and Gamble Distributing Company on behalf of themselves and all other businesses in similar situations. The suit alleges that the Multistate Tax Compact violates: the U. S. Constitution, Article I, section ten, clause three which says "No state shall, without the consent of congress, . . . enter into any agreement or compact with another state, or with a foreign power" If this suit is upheld by a panel of three federal judges, the Compact will be ineffective unless recognized by Congress. This would be a severe blow to the audit program of Montana and the eighteen other states which are members of the Compact. An association such as the Multistate Tax Compact is the only organization that can insure that a corporation pays taxes in the various states on 100 percent of the corporation's income. Individual state audits cannot verify this fact because a single state does not have access to the returns filed by corporations in all other states. It would be of great benefit to all states that tax the income of multistate corporations if Congress would formally recognize the Multistate Tax Compact and consent to allowing the states to join this compact for tax

administrative purposes. This would eliminate the basis for the present lawsuit and it would encourage more states to become members of the Compact.

Aside from the Multistate Tax Compact, the Department of Revenue has made significant advancement in the areas of administration and audit during the past fiscal year. The employment of two corporate field auditors has given the state the capability of examining the tax records of multistate corporations for the first time. During the first three months of this fiscal year, audits were completed on twelve multistate corporations and these companies were assessed additional taxes of \$46,213.75. It is anticipated that audits now under way and those planned for this fiscal year will result in several hundred thousand dollars of additional assessments against multistate corporations. Expansion of the field audit program during the next biennium should be highly productive for the state and well worth the money invested to hire qualified personnel.

CHAPTER SIX

CONCLUSIONS AND RECOMMENDATIONS

This study of corporation taxation on Montana was designed primarily to be educational rather than analytical. This is because it is our conviction that most of the criticism of the corporate tax structure and administration in Montana, is the result of lack of understanding of the powers of the state to tax interstate corporations. Most people believe that if a corporation is earning money from operations in Montana that it must be liable for state corporate income taxes. We have explained that the legal definitions of "doing business", established primarily by federal laws, are not always based on the income a corporation has earned from operations within the state. Many firms are earning income from sales in Montana but they are not paying taxes to the state. This is not the fault of the legislature or the Department of Revenue. Neither organization can change the federal laws that allow this situation to exist.

Our review of existing state laws indicates that the legislature has done a good job in passing laws that allow the state to tax the maximum number of multistate businesses. There is little more that can be done in so far as the basic tax structure is concerned. There

are minor changes to the law that the Department of Revenue will recommend to the 1973 Legislative Assembly. However, most of these modifications are technical and concern the day-to-day operations of the agency and are not pertinent to this report.

The statistical analysis conducted in conjunction with this study and in previous studies, indicates that any of the popular alternatives to Montana's tax system would result in a greater tax burden on domestic corporations and a lesser burden on those corporations that do business in more than one state. Consequently, we recommend that no major changes to Montana's corporate tax structure be initiated.

With respect to the taxation of multistate firms, our conclusions simply reaffirm and enforce the conclusions reached by the Legislative Council in 1968 and the Interim Committee on Fiscal Affairs in 1970. However, this report discusses the tax treatment of small business corporations, a subject largely ignored in past studies. Small business corporations receive favorable tax treatment not available to normal corporations. We cannot judge the wisdom of such a policy, but it does result in lower corporate tax collections than would be obtained if these firms were taxed as regular corporations. On the other hand, all of the small business corporations are owned and operated by Montanans, not out-of-state interests and there may

be merit in providing tax incentives to small, Montana corporations.

Many people feel that the state should be receiving considerably more tax revenue from corporations than it does at present. Our conclusion with respect to revenue is that the only viable way to increase revenue substantially is to increase the corporation license tax rate substantially. The Department of Revenue does not recommend an arbitrary increase in corporate tax rates. We have indicated that the corporate license tax is only a fraction of the total taxes paid by businesses in Montana. When all taxes paid by businesses are considered, Montana ranks fifth among the fifty states in reliance on business taxes to finance state and local government services.

One substantive recommendation resulting from this study, is that the Montana Legislature adopt Article VIII of the Multistate Tax Compact. This is the audit article and it authorizes the state to utilize the audit capabilities of the compact to the maximum extent. Montana currently receives the benefits of the multistate audit staff (40,000 dollars in additional assessments in 1972), but full recognition of Article VIII would be in the state's interest. Of course, if the law suit initiated by United States Steel and others is upheld, the Multistate Tax Compact will be rendered ineffectual unless recognized by Congress. Nevertheless, Montana should take full

advantage of its membership in the Multistate Tax Compact and extend full recognition and support to the organization. It is a worthwhile effort by the states to initiate procedures to ensure that all states receive fair tax payments from corporations and it also strives to insure that corporations are treated fairly by the member states.

We hope that this study is of value to the Legislative Assembly and the people of Montana in fostering a better understanding of the structure and administration of state business tax laws.

